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IN THE

Supreme Court of the United States

OCTOBER TERM, 1963

CHICAGO & EASTERN ILLINOIS RAILROAD CO., an Indiana corporation, et al.,

Petitioners,

vs.

PAUL J. KERN and IRVING M. LESCH,

Respondents.

REPLY TO BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI.

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REPLY TO BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI.

Respondents' brief opposing review fails to meet petitioners' contentions.

1. Respondents repeatedly say that the sole question is the construction of petitioner railroad's articles of incorporation, a matter of state law. This, it is true, was the basic question before the Illinois courts. But the state was Indiana, not Illinois. And in deciding the question, the Illinois courts wrongly created and injected federal law into the Indiana certificate or articles of incorporation.

One federal question was the Illinois Appellate Court's finding that the federal plan of reorganization forbad staggered terms for the railroad's board of directors. This

holding under the federal bankruptcy law was then applied to the Indiana certificate of incorporation. The Illinois courts thereby disregarded relevant Indiana law as set forth in Indiana statutes. This result involved another federal issue, the violation of the Full Faith and Credit Clause of the United States constitution.

2. Respondents' entire argument is based on an assumption (p. 6) that the railroad's certificate of incorporation "expressly prevented" staggered terms for the railroad's board of directors without a ⅔ vote of the Class A shareholders. Nowhere does respondents' brief quote or cite the provision of the certificate on which they rely. There is no such provision.

3. It is noteworthy that the respondents, having obtained a declaratory judgment from the Illinois courts and wanting to avoid federal review of a federal question, say now that the provisions of the reorganization plan "are not directly involved in this case in any manner" (Brief in Opposition, p. 3). Five of the eleven paragraphs of respondents' complaint contained allegations concerning the plan of reorganization (A. 2-6), even to the extent of describing staggered terms as a "complete violation of the plan of reorganization" (A. 5). In the Appellate Court's decisive first opinion[1], 14 of the 24 paragraphs discussed or referred to the plan of reorganization (App. 1a-2a), as in the statements (ital. added):

> "The principal issue is whether that amendment is in violation of a provision for cumulative voting and annual election of all directors, as contained in *a reorganization plan, a decree of court* . . ." (App. 1a).

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[1] The trial court's decree and the Appellate Court's second opinion held that the first opinion's ruling on the merits was the law of the case (App. 14a, 26a).

"Thus, the maximum number of directors . . . was to have been five and the minimum, four, thereby creating a system of classified directors and staggered elections and sharply qualifying or completely defeating *the cumulative voting provisions of the plan.*" (App. 2a)

"The question is whether the power of minority shareholders . . . should be diminished or extinguished in contravention of *the provisions of a plan of reorganization, a decree of court* . . ." (App. 4a).

"Defendants contend that *the plan of reorganization* . . . was not intended as a restriction extending into infinity. . . . We do not believe that *the reorganizers* so considered it when it was prepared or that *the court* had such an interpretation in mind when it was approved." (App. 5a-6a)

"Defendants further argue that there is no requirement in the certificate of incorporation inflexibly fixing the number of directors at thirteen, . . . That is drawing a farfetched inference in order to override the language to the contrary in *the plan of reorganization* . . ." (App. 6a).

"The *plan of reorganization* unconditionally fixes the term of each director at one year. There is nothing in the language of the certificate of incorporation which negates this clear and unambiguous language embodied in *the Commission order.*" (App. 7a)

"It was natural . . . that *a plan of reorganization* providing for cumulative voting should also include a provision for the election of the directors annually. Such a provision is important to the holders of stock having cumulative voting rights. Otherwise, the right is a snare and a delusion." (App. 8a)

"Defendants argue that since the certificate of incorporation provides that there be no distinction as to class in matters pertaining to the cumulative

election of directors, the Class A preferred shareholders had no rights peculiar to them as a class in such elections, . . . The answer to this contention is that preferred shareholders are preferred[2], and that the rights which protect them against dilution of their power to elect directors were given to them by *the plan of reorganization* . . ." (App. 9a).

"Defendants contend that plaintiffs are estopped . . . because Kern participated and acquiesced . . . The violation of their rights is *in contravention of* an Interstate Commerce Commission *order, the plan of reorganization, the Federal court decree,* . . ." (App. 9a).

Even the Appellate Court's final paragraph discussing the plan (App. 11a), although acknowledging that the cer-

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[2] The Appellate Court's error in federal law is illustrated by this statement that "preferred shareholders are preferred". The reorganization plan spoke of two classes of stock, common and preferred (App. 44a-45a). But in 1940 the certificate of incorporation (approved by the bankruptcy court) provided instead for issuance of 383,000 shares of Class A stock and 343,000 shares of common stock, with no shares designated "preferred" (A. 135). When the complaint was filed in 1958 the relative positions had changed to 75,000 of Class A and 426,000 of common. The complaint called the Class A stock "preferred" (A. 3). The Appellate Court, while holding that a declaration of stockholders' rights was required, wrongly described this class of stock as "Class A preferred". Then in the quoted phrase it interpreted the word "preferred" in the plan as giving the Class A stock a special position with special rights in addition to those described in the certificate of incorporation. As said in *Guttmann* v. *I.C. R.R. Co.*, 189 F. 2d 927, 930 ((C.A. 2, 1951), by a court consisting of Circuit Judges L. Hand, Chase, and Frank,

". . . the preferred stockholders are not—like sailors or idiots or infants—wards of the judiciary".

This was said of an Illinois railroad corporation in following Mr. Justice Holmes' opinion concerning an Indiana railroad corporation in *Wabash Ry. Co.* v. *Barclay*, 280 U.S. 197 (1930).

tificate of incorporation controls, admitted that the opinion had "*given weight* to the provisions of the plan of reorganization".

The Appellate Court read into the reorganization plan the Illinois constitutional principle that staggered terms are forbidden by a requirement of cumulative voting (Pet'n. 17). The Appellate Court created and applied federal law by construing and giving effect to the federal plan of reorganization and to the ICC order and federal court decree approving the plan. The heavy weight given to these federal legal instruments tipped the scales in favor of the respondent. The federal questions, despite respondents' present disclaimers, were decisive.

4. Respondents' brief ignores and therefore concedes two facts that emphasize the need for review.

Respondents concede that the decree, in addition to forbidding staggered terms, also requires thirteen members for the railroad's board of directors unless the holders of ⅔ of the Class A stock consent to a change. An Indiana statute expressly permits a majority of the stockholders to fix the number of directors at from five to thirteen (Pet'n. pp. 14-15). The decree's flagrant disregard of this Indiana statute alone presents a substantial federal question.

Of greater practical importance is the respondents' silent admission that the decree is strongly weighted in favor of the holders of the railroad's 75,000 Class A shareholders to the detriment of the holders of 426,000 common shares (Pet'n. pp. 9, 19). The federal reorganization plan is used in the decree to extend the scope of the ⅔ vote clause of the certificate of incorporation and thereby greatly overbalance the position of the Class A stock in relation to the common stock.

CONCLUSION.

Respondents' brief fails to demonstrate that review should be denied. The federal questions presented may be subtle, but they are serious and substantial. Certiorari should be granted.

Respectfully submitted,

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